



BERMUDA MONETARY AUTHORITY

DISCUSSION PAPER

ON

IMPLEMENTING GROUP-WIDE SUPERVISION

31ST March 2009

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This paper outlines the Authority's proposal for the implementation of a group-wide supervisory framework.

The views of the insurance industry and other interested persons on the proposals set out in this paper are invited. Comments should be sent to the Authority addressed to policy@bma.bm not later than May 29th, 2009.

1 Executive Summary

1. A significant number of Bermuda licensed insurers¹ currently operate within a group structure. The financial position and risk profile of an insurer may be affected by its belonging to a group, with the possibility of both positive and negative effects on its prudential position.² An example of a positive effect would be group financial support during times of stress while a negative effect would be financial or operational risk exposure to distressed affiliates.

2. Group-wide supervision could contribute to sound insurance markets, optimal capital usage and policyholder protection. It could also lead to improved regulation and efficiencies that eliminate duplicate supervisory efforts. Further, it should be noted that group-wide supervision is intended to supplement solo supervision and does not negate or supersede the responsibilities of the solo supervisor.

3. Consequently, it is important for the Bermuda Monetary Authority (“the Authority”) to be able to form a comprehensive view of the overall risk exposure of the group as a whole through group-wide supervision. To this end, the Authority proposes to introduce group-wide supervision for insurance groups and insurance subgroups that form part of a financial group or mixed conglomerate (see Appendix I). Initially, the Authority proposes to apply its group-wide supervisory regime to Class 4 and Class 3B insurers because of their higher risk profile.

4. The discussion paper underscores the key global debates and issues surrounding group-wide supervision that will guide the Authority as it strives to implement its group-wide supervisory framework. Specific options have been put forward throughout this paper highlighting the initial policy approaches and proposals that the Authority may implement in order to facilitate a group-wide supervisory framework. The Authority also recognises that its proposed group-wide supervisory framework will necessitate the requisite changes to legislation.

¹ In this paper, the term Insurer is used synonymously with the term Reinsurer.

² IAIS Principles on group-wide supervision October 2008.

5. Section 2 introduces the concept of group-wide supervision, including the driving forces and international trends supporting its development. It also explains the Authority's existing supervisory regime and the impetus for developing a group-wide supervisory framework.

6. Section 3 describes the Authority's proposed scope of the group-wide supervisory framework. It begins with a definition of a group and states that the scope of group-wide supervision would be applied to the Class 4 and Class 3B insurers. This section also outlines the Authority's proposal regarding the conditions by which it would seek to be considered the Group-wide Supervisor. The group-wide supervisory framework hinges on the precepts of cooperation and equivalence. This section seeks to explain the equivalence framework advanced by the Authority, the use of supervisory colleges, and other forms of cooperation to facilitate group-wide supervision.

7. Section 4 describes the Authority's proposed group-wide supervisory framework. It discusses supervisory processes surrounding the assessment of group corporate governance and risk management. The section also describes the Authority's proposals for group-wide solvency assessment. It takes into account the treatment of intra-group transactions and risk concentrations, and the efficacy of group support as an important factor in determining group-wide solvency. The Authority also submits how it proposes to treat unregulated and/or non-financial entities that are part of the group. The section concludes with the Authority's proposed statutory reporting requirements for groups. The proposals set forth in section 4 are currently being addressed in greater detail in subsequent consultation papers that will be issued in 2009.

8. The discussion paper culminates with section 5 which presents the Authority's proposed group-wide supervision implementation timetable and an information request to be issued to the industry to better assist the Authority in developing its group-wide supervisory and policy framework.

2 Background

2.1 Need for Group-wide Supervision

9. Globalisation of financial markets created the catalyst for the development of financial groups³, which have increased in numbers, complexity and size. These groups provide a range of services, such as insurance, banking and securities. They operate simultaneously across financial sectors throughout the global financial system.

10. The growth of the number of groups involved in insurance activity has increased substantially in the last decade against a backdrop of continually evolving legislation and regulatory framework(s) which have not kept pace. Consequently, groups that have developed as a result of mergers and acquisitions have stressed regulatory systems by virtue of their increasing complexity.

11. Groups tend to become intrinsically ingrained into financial/economic systems, both locally and globally. The credit crisis has accentuated just how embedded these groups are as governments and central banks have had to implement emergency measures to stabilise and/or stem the recessionary effects on their economies. The adoption of group-wide supervision has emerged as a critical need to help ensure that groups are effectively regulated and conduct their operations in both a prudent and financially sound manner.

12. This is particularly important for groups that operate in various jurisdictions and conduct cross-sectoral activities. Failures in supervision have highlighted the deficiencies in traditional supervisory frameworks, where oversight was restricted to the legal entity. As such, the supervisor may have been unable to efficiently supervise the legal entity on account of operational influences from other parts of the group outside the jurisdiction of the supervisory framework.

³ In this paper, the term Financial Group is used synonymously with the term Financial Conglomerate. Financial Conglomerates contain companies that operate across various financial sectors; however, the group can also be limited to a single financial sector.

13. Globally, supervisory practices are in various stages of development as supervisors are seeking to supplement solo supervision with methodologies that reflect the more complex task of supervising a group. International bodies have recognised the need to develop regulation for financial groups, and are working on group-wide supervisory frameworks that will assist jurisdictions in establishing sound regimes.

14. The Tripartite Group of Bank, Securities and Insurance Regulators (“the Tripartite Group”) in its paper, “The Supervision of Financial Conglomerates”, identified a number of supervisory issues⁴ which have contributed to the need for group-wide supervision. These are as follows:

- a. developing a group-wide supervisory framework which regulates the legal entities within the group, and is complemented by an assessment of the financial group as a whole;
- b. mitigating group contagion effects where parts of the group can adversely affect the rest of the group. These contagion effects can prompt potential insolvency or contravene regulatory requirements in relevant jurisdictions;
- c. identifying risk concentration and intra-group transactions, which present substantial credit risk, and can affect the liquidity position of the various legal entities and the group as a whole;
- d. determining group capital adequacy including appropriate instruments that meet capital requirements. Also, eliminating the effects of double gearing in computing group capital requirements;
- e. determining the fitness and propriety of the group’s board of directors (“the board or group board”), shareholders and senior management. This issue heightens in importance as the group becomes more complex and diversified in nature;
- f. ensuring that the group has appropriate risk management and internal controls suited for its nature, size and complexity;

⁴ The Supervision of Financial Conglomerates – A report by the Tripartite Group of Bank, Securities and Insurance Regulators July 1995.

- g. accessing prudential information on the group and its activities so as to effectively supervise the legal entities and the group as a whole; and
- h. eliminating supervisory arbitrage where a group can conduct its activities in jurisdictions with varying degrees of regulatory oversight.

15. The International Association of Insurance Supervisors (“the IAIS”) stated that an insurer that is part of a group, is affected by exposures pertinent to that group, and as such, supervision should not be restricted to solo supervision of the insurer. The IAIS supports a group-wide assessment⁵ in order to adequately supervise the insurer. It also asserts that requisite legal provisions should be in place to support effective supervision of an insurer that is part of a group.

16. The IAIS has also advanced a definition of group-wide supervision as follows: “A supervisory approach to a financial group which considers the group structure, the constituent licensed entities, and all the interrelationships within that financial group.”⁶ The Authority has recognised the need to develop its supervisory regime to address group-wide supervision, and has taken into account views advanced by the IAIS and other international bodies.

17. While there is broad acceptance of the need for group-wide supervision, there is also a divergence of opinions on how it should be done. This is due mainly to the differences in legislative and regulatory frameworks in various jurisdictions. Consequently the appropriateness of any approach can only be properly considered in the context of the unique circumstances of a particular group and the jurisdiction(s) it operates in.

18. Unique factors influencing the nature of the group-supervisory framework include:⁷

⁵ IAIS Insurance Core Principle 17: Group-wide Supervision October 2003.

⁶ IAIS Principles on group-wide supervision October 2008.

⁷ IAIS Issues Paper on group-wide solvency assessment and supervision March 2009.

- a. the jurisdictions within which the group operates, the similarities and differences between their legal, regulatory and solvency regimes, including supervisory powers and authorities;
- b. the complexity of the group structure and the relative significance of the particular insurer within that group, e.g. regulated and unregulated entities, insurance and non-insurance companies;
- c. the management structure of the group, and the extent to which it operates as a single integrated entity or as a group of separate entities; and
- d. the relative solvency position of entities within the group, when compared on a consistent basis taking into account the triggers for supervisory intervention in each jurisdiction.

19. Despite the complexities surrounding group-wide supervision, it is important for the Authority to form a comprehensive view of the overall risk exposure of these groups, especially as they affect the legal entities operating within Bermuda. This will enable the Authority to better assess the prudential situation and consequentially, allow the Authority to mitigate any potentially adverse influence on the Bermuda financial market system.

20. It should be noted that the Authority currently applies group-wide supervision to Bermuda licensed non-insurance financial entities, specifically, banking, trust and investment entities where the mind and management resides in Bermuda. In this regime, where risk exposures emanate from parts of the group located outside of Bermuda, the Authority seeks to satisfy itself that the entity is maintaining appropriate oversight and control of these risk exposures by communicating and coordinating with other supervisors,

21. Currently, although the Authority does not apply a group-wide supervisory framework to insurance entities, the supervisory review process does seek to understand the influences that the group may have upon the Bermuda insurance legal entity. The Authority's onsite and advanced risk assessment tools evaluate the inherent risk exposures within the legal entity and exposures arising from its being part of a group. Additionally, the review includes the legal entity's importance to the group, particularly where the legal entity provides support to

the group and its activities. Intra-group exposures are examined carefully, especially where the Bermuda legal entity:

- a. has material investments in/or loans to affiliated companies;
- b. engages in significant intra-group transactions; or
- c. has parental support arrangements in place.

22. The Authority is able to cooperate with regulators from other jurisdictions and exchange information on the group and its activities that pertain to the operations of the Bermuda legal entity, through its established information gateways.

23. Although the above approach does provide some insight into the group's effects on Bermuda regulated entities, the Authority's understanding, and prudential oversight of insurance entities would be enhanced if the legislative and supervisory framework facilitates a comprehensive view of the group and its business activities.

24. While the Authority pursues development of its group-wide supervisory framework for insurance entities, it will continue to apply the existing non-insurance group supervisory regime to the non-insurance entities within the group. Consequently, the Authority will assign an in-house lead supervisor, based upon the group's predominant financial activities, who will coordinate all sectoral supervisory efforts. The objective is to be more effective and efficient by eliminating supervisory gaps, while avoiding duplication of effort and unduly burdening the group.

25. The subsequent sections in the discussion paper outline the Authority's approach, the companies to be affected, and other key issues surrounding the proposed group-wide supervisory regime. At a very high level, the Authority's proposals can be summarised as requiring:

- a. supervisory oversight of group risks;
- b. co-ordination between supervisors involved with a group; and

- c. preparation of a consolidated, group solvency assessment.

While group-wide supervision does not involve the Authority supervising each legal entity within the group; the Authority will, however, retain responsibility for oversight of the legal entities operating within Bermuda.

3. Proposed Scope of Group-wide Supervision Framework

3.1 Proposed Definition of a Group

26. To date, the IAIS' publications on group-wide supervision have focussed on groups "whose main activity is insurance, including reinsurance groups and an insurance subgroup within a financial conglomerate."⁸ The Authority proposes to adopt the same focus. Therefore, this paper outlines the Authority's proposals for developing a group-wide supervisory framework for groups and subgroups whose primary activity is insurance (hereafter, the term groups will be used to mean insurance groups and subgroups, unless otherwise stated).
27. There are a number of groups⁹ operating within Bermuda which conduct cross-border activities. The Authority proposes to initially apply its group-wide supervisory framework to its groups, specifically, the Class 4, and Class 3B insurers. This would mean that these classes of insurers would be supervised by a Group-wide Supervisor. This role will either be filled by the Authority or another supervisor from an equivalent regime that is willing and able to assume this role (see subsection 3.2 for further details). Where there is no such supervisor in place, the Authority may consider itself as the Group-wide Supervisor for the Bermuda insurance sub-group, including foreign subsidiaries of the sub-group. The objective is to ensure that all Class 4 and Class 3B insurers are subject to group-wide supervision, or at least their Bermuda operations (including foreign subsidiaries).

⁸IAIS Guidance Paper on the Role and Responsibilities of a group-wide supervisor October 2008.

⁹ See Appendix I for the types of group structures operating in Bermuda.

28. Where an insurer is subject to group-wide supervision, then all group legal entities and parent companies, whether regulated or not and whether based in Bermuda or not, must be included within the assessment of group risks and the calculation of group solvency as described in section 4 of this paper. In other words, group-wide supervision is focused at the group level and does not extend the Authority’s supervisory responsibility into each and every group entity. Where applying the relevant statutory test as the Group-wide Supervisor (see subsection 3.2), the Authority would be given powers to obtain information about affiliates, subsidiaries and parents in relation to its group-wide supervisory functions.

3.2 Role and Determination of the Group-Wide Supervisor

29. Groups that operate in various jurisdictions are usually subject to supervision of the individual parts of the group by the respective supervisors (solo supervisory model). Each supervisor regulates the individual entity; however, no one regulator acting alone is able to view the group as a single economic unit. In order to get a complete view of the group, supervisory cooperation is required. This cooperation can be facilitated by the selection or appointment of a Group-wide Supervisor.

30. The role of the Group-wide Supervisor is primarily to “[coordinate] the input of solo supervisors”¹⁰. Additionally, the Group-wide Supervisor would be responsible for assessing the overall “risk and solvency of the group on a group-wide basis”¹¹ through appropriate reliance upon the work performed by other foreign supervisors.

31. The Authority intends to perform its functions as the Group-wide Supervisor in accordance with the principles identified by the IAIS’ “Guidance Paper on the role and responsibilities of the Group-wide Supervisor”. This paper identifies the following key responsibilities of the Group-wide Supervisor:

¹⁰ Ibid

¹¹ Ibid

- a. to assess the fitness and propriety of the significant owners and managers at the group level;
- b. to assess the overall standard and compliance of the group's corporate governance;
- c. to assess the group's risk management and internal control systems;
- d. to identify and measure all material risks of the group and to ensure that sufficient capital is allocated to those risks;
- e. to undertake a group-wide risk analysis including risk concentration and group contagion effects;
- f. to assess the adequacy of group capital and solvency position; and
- g. to evaluate intra-group transactions as they affect the group's capital adequacy position.

32. The following factors will be relevant to the Authority's determination as to who should be the Group-wide Supervisor:

- a. the location of the "mind and management" of the group's ultimate parent, such as the location of the head office or where the group's board and senior management principally meet to direct operations;
- b. the location of the group's ultimate parent, whether the ultimate parent is a non-financial entity, such as a holding company or a financial entity, such as an insurance company;
- c. the location of the group's main business activities; and
- d. the presence of another relevant supervisor from an equivalent regime that is willing and able to discharge the responsibilities of the Group-wide Supervisor.

33. In light of the afore-mentioned factors, the Authority proposes the following¹²:

¹² See Appendix II for a diagrammatical representation of the Authority's proposals.

- a. where the parent company and head office or mind and management of a group are both located in Bermuda, the Authority would make a determination that it should be the designated Group-wide Supervisor;
- b. where the parent company is based outside of Bermuda but the head office or mind and management is located in Bermuda, the Authority may determine that it should be the Group-wide Supervisor, but will consider an alternative Group-wide Supervisor if there is another supervisor from an equivalent regime that is willing and able to discharge the functions of the Group-wide Supervisor;
- c. where the head office or mind and management is outside of Bermuda, the Authority would consider making a determination that it should be the Group-wide Supervisor in light of the following considerations:
 - i. the main business activities are undertaken in Bermuda;
 - ii. the main risks are underwritten in Bermuda; or
 - iii. the group has its largest balance sheet total in Bermuda.
- d. where there is an appointed Group-wide Supervisor, the Authority may determine that the group-wide supervisory arrangements are not equivalent, and, it may undertake the role of Group-wide Supervisor for those insurance entities located within Bermuda (including their foreign subsidiaries).

34. The Authority believes that the principles-based approach will allow for a flexible framework that can be adapted to the particular circumstances of each insurer. This means that legislation will need to be flexible by providing discretion to the Authority to make a determination as to when it can become the Group-wide Supervisor, rather than prescribing a 'black and white' legal test or definition.

3.3 Equivalence and Mutual Recognition

35. The effectiveness of the Group-wide Supervisor relies on the fact that the relevant solo supervisors have confidence in the Group-wide Supervisor's ability to effectively, and appropriately supervise the group. Accordingly, group-wide supervision requires that the

relevant solo supervisors recognise that the group-wide supervisory framework passes the equivalency test vis-à-vis their own supervisory frameworks.

36. To engender confidence, and achieve recognition as an acceptable Group-wide Supervisor, the Authority will develop its group-wide supervisory framework in accordance with international standards. The Authority will also evaluate other jurisdictions and their supervisory frameworks when they seek to be considered the Group-wide Supervisor of any group containing Bermuda licensed entities.
37. The Authority proposes to conduct its evaluation using a principles-based approach when broadly assessing the foreign jurisdiction's insurance legislative and supervisory frameworks. This broad equivalence test would enable the Authority to be satisfied that the jurisdiction has the requisite framework and expertise to achieve the supervisory outcomes acceptable to the Authority.
38. In addition to using IAIS Insurance Core Principles as part of its jurisdictional assessment, the Authority would rely upon work conducted by international bodies such as the International Monetary Fund under the Financial Sector Assessment Programme. The Authority may also rely upon the equivalence assessment conducted by the European Union ("EU"). This reliance on other international bodies' assessment programmes infuses transparency and objectivity within the process and may facilitate convergence in the assessment processes.
39. The Authority may, inter alia, also consider in its equivalence assessment the following arrangements:
 - a. the other jurisdiction's solvency rules, especially as they pertain to the Bermuda insurance entities;
 - b. the other jurisdiction's solvency and financial protection legislation, which may hinder transfer of capital;

- c. insolvency proceedings in other jurisdictions, which, if effected, may trigger winding up of the Bermuda entity;
- d. the Authority's ability to access information from the relevant supervisors; and
- e. the other jurisdiction's code of conduct for its insurers.

40. The Authority will explore options under the following scenarios:

- a. if the home jurisdiction is considered equivalent, the Authority may accept the home jurisdiction as the Group-wide Supervisor.
- b. if the home jurisdiction is largely equivalent where there are aspects within the supervisory regime the Authority regards as not equivalent vis-à-vis the Bermuda supervisory regime, then the Authority may accept the home jurisdiction as the Group-wide Supervisor. The Authority may, however, introduce additional requirements that would address supervisory gaps, as they pertain to the group's impact on the Bermuda legal entities.
- c. if the home jurisdiction is not considered equivalent, the Authority may consider requesting that the group establish a locally incorporated parent over the Bermuda legal entities or, in the case of Bermuda branch operations, require that the branch be incorporated. In this way, the Authority will be able to exercise group-wide supervisory control over the sub-group.

41. The Authority may apply additional supervisory oversight and prudential requirements over the Bermuda entities whose parent is regulated in a jurisdiction that is not considered equivalent.

42. The equivalence assessment will also be relevant in other circumstances. If a group wishes to employ the risk-based aggregation method of calculating its group solvency requirements (see subsection 4.2.2), it will need to establish whether the solo solvency calculations of the non-Bermuda insurers are from an equivalent jurisdiction. Where the insurance entity is from an equivalent jurisdiction, the Authority will accept that solvency calculation in the aggregation calculation. Where it is not from an equivalent regime, the

group will have to apply the Authority's solvency rules to calculate the solvency requirement of that insurance entity before it is aggregated.

3.4 Supervisory Colleges and Supervisory Co-operation

43. The IAIS views supervisory cooperation and information exchange as necessary inputs to achieve effective group-wide supervision. Since supervisors are only privy to the risk characteristics of the legal entities in their jurisdiction, no one supervisor alone has an understanding of the entire group where operations span multiple jurisdictions. Therefore, group-wide supervision requires receiving the various informational inputs to achieve a more holistic review of the group's business activities, risk management culture, and corporate governance.
44. This cooperation can be achieved through mechanisms such as memoranda of understanding ("MoU"), supervisory colleges, or other forms of legislative information gateways.
45. The Authority has, currently within its legislative framework, the ability to share information with other supervisors. The Authority is signatory to a number of MoUs with other supervisory authorities, and is seeking to be a signatory of the IAIS Multilateral Memorandum of Understanding ("IAIS MMoU"), whose objective is to facilitate the "formal basis for cooperation and information exchange between the Signatory Authorities regarding the supervision of insurance companies where cross-border aspects arise."¹³
46. The Financial Stability Forum ("FSF") stated that supervisory cooperation and information exchange would assist in addressing cross-border issues, which were brought to the forefront during the global credit crisis. The FSF saw supervisory colleges as one of the mechanisms to enhance "systematic cross-border supervisory cooperation"¹⁴ whose purpose

¹³ IAIS Multilateral Memorandum of Understanding on Cooperation and Information Exchange (IAIS MMoU) February 2007

¹⁴ Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience: 7 April 2008

“would be to enhance cooperation on ongoing supervisory issues.”¹⁵ The FSF recommended that supervisors ensure that there is a supervisory college for all large financial institutions by December 2008.

47. As Group-wide Supervisor, the Authority sees itself as being responsible for coordinating supervisory colleges, and fostering supervisory cooperation and information sharing amongst the relevant supervisors.

48. In an effort to progress its group-wide supervisory agenda, the Authority has already conducted supervisory colleges for some of its large groups. The objectives of the supervisory colleges were:

- a. for the Authority and the other relevant supervisors to attain a greater understanding of the group under review, including its operations and business activities;
- b. to enhance the level of cooperation already experienced by the supervisors; and
- c. to foster confidence in the Authority’s ability to supervise these groups.

49. The Authority will continue to host supervisory colleges as an interim measure to promote coordinated supervision of groups. When the group-wide supervisory framework is in place, the Authority intends to regularly host supervisory colleges for all large groups where it is the Group-wide Supervisor. Where the Authority is not the Group-wide Supervisor, it will participate in supervisory colleges conducted by the Group-wide Supervisor.

4. Proposed Supervisory Framework for Group-wide Supervision

50. A number of factors need to be carefully considered and appropriately implemented for the group-wide supervisory framework to be effective. Such considerations include:

¹⁵ Ibid

- a. group corporate governance and risk management;
- b. group solvency – including the solvency approach, group support, intra-group transactions and risk concentrations;
- c. treatment of unregulated and non-financial entities; and
- d. group statutory reporting and filing requirements.

4.1 Proposed Group Corporate Governance and Risk Management Framework

51. “Corporate governance refers to the rules and procedures put in place within a corporation for the management and control of its business and affairs. What makes structures and policies work in practice is a knowledgeable and competent board, with a clear understanding of its role and strong commitment to carrying it out.”¹⁶
52. Groups generally adopt a centralised approach to corporate governance and risk management where the head office determines the corporate governance and risk management structures for the entire group. It is usually the responsibility of the parent to provide direction to the legal entities on implementing and harmonising these processes throughout the group. The Authority’s position is that “the prime responsibility for the sound and prudent management of a [group] rests with the board of the [group]”.¹⁷
53. The Authority recognises that the group (or an insurer) faces risks that cannot be mitigated by capital alone but, more appropriately, requires sound governance and effective risk management. Accordingly, the Authority views the board, along with management as being “responsible for suitable prudential oversight of the risk management and internal control systems, strategies and policies.” While the “development and implementation of an adequate and sound system of internal controls is normally the responsibility of

¹⁶ Bermuda Monetary Authority Guidance Note #12 Corporate Governance March 2005

¹⁷ Ibid

management”, the board is ultimately responsible for ensuring that such a system is established and maintained.”¹⁸

54. As Group-wide Supervisor, the Authority will also require that the group establish an internal controls system, which “facilitates the efficiency of operations, contributes to effective risk management, assists compliance with applicable laws and regulations, and strengthens capacity to respond appropriately to business opportunities.”¹⁹

55. Although many of the insurance entities that operate in Bermuda are publicly traded companies on major stock exchanges, and are already obligated to implement requirements pertaining to governance and risk management within their operations, the Authority will require that the group establish a sound corporate governance and risk management infrastructure, and will be assessing the group in that regard.

56. The Authority presently has a corporate governance and risk management assessment framework as conveyed in Guidance Notes #12²⁰ and #13²¹. While these Guidance Notes are applicable to solo legal entities, the Authority proposes to extend these principles to groups.

57. The corporate governance and risk management frameworks would be assessed by the Authority to ensure, inter alia:

- a. there is a balance of appropriately skilled, experienced and qualified individuals operating at the board level, who can make informed judgments on the group’s activities;
- b. collectively, the board has the appropriate breadth of experience, ability and integrity to conduct the group’s business, taking into account potential conflicts of interest;

¹⁸ Bermuda Monetary Authority Guidance Note #13 Risk Management and Internal Controls March 2005

¹⁹ Ibid

²⁰ Bermuda Monetary Authority Guidance Note #12 Corporate Governance March 2005

²¹ Bermuda Monetary Authority Guidance Note #13 Risk Management and Internal Controls March 2005

- c. the board reviews and approves the group's broad business strategies including procedures to monitor and evaluate the progress of the strategies;
- d. the board establishes independent risk management functions that identify and monitor material risks affecting the group;
- e. there is a clear distinction in responsibilities to ensure that there is a balance of power and authority among the board;
- f. the board undertakes fitness and propriety assessments of the group's senior management;
- g. the board provides oversight of the group's market conduct and establishes policies that address conflicts of interest, fair treatment of customers, and sharing information with stakeholders;
- h. the board establishes standards of business conduct and ethical behaviour for directors, management and other personnel. This includes policies on private transactions, self dealing, preferential treatment of favoured internal and external entities, covering trading losses, and other inordinate trade practices of a non-arm's length nature;
- i. the board ensures that the group complies with all relevant laws, regulations, guidance notes, industry standards and codes of conduct in the various jurisdictions where the group operates;
- j. the group is able to identify all material risks, whether financial or non-financial and assess the potential impact. The board has established the appropriate risk tolerance limits for the material risks it faces;
- k. the group's risk management framework contains policies, procedures and practices that:
 - i. clearly delineate lines of responsibility for managing risk;
 - ii. set in place adequate systems for measuring risk;
 - iii. create appropriate structured limits on risk taking;
 - iv. establish effective internal controls; and
 - v. describe comprehensive and timely risk monitoring and reporting.
- l. the group establishes an appropriate internal controls system to ensure proper functioning of the group's business.

58. The Authority will review the group's internal controls to ensure that:

- a. the group's business activities are conducted in a prudent manner in accordance with the policies and strategies established by the board;
- b. clear delegation of responsibilities are being adhered to;
- c. assets are safeguarded;
- d. accounting and other records provide complete, accurate, verifiable and timely information; and
- e. management is able to identify, assess, manage and control the risks of the business and hold sufficient capital for these risks.

The Authority will incorporate these principles into a code of conduct for legislative effect which will be regularly reviewed to ensure compliance with international standards. Enhancements will be made where required.

59. In its capacity as Group-wide Supervisor, the Authority, will assess the following:

- a. the fitness and propriety of the board, senior management and significant shareholders;
- b. the fitness and propriety of the group's actuary and external auditor;
- c. "the overall standard and compliance of the corporate governance of the group"²². Where the group's parent is a non-financial entity (e.g. a holding company), the corporate governance assessment will be done at the head of the group²³ (see subsection 4.3 for further clarification);
- d. the group's adherence to the Authority's code of conduct (when published). The Authority places the responsibility on the board to ensure compliance, and in the event the group and/or any of its subsidiaries are unable to comply, the matter should be reported to the Authority for consideration;

²² IAIS Guidance Paper on the role and responsibilities of a group-wide supervisor October 2008

²³ Ibid

- e. the group's internal controls and risk management systems;
- f. the risk management surrounding the group's intra-group transactions and risk concentrations; and
- g. whether the group's risk management framework is reviewed regularly by the board.

Additionally, the Authority proposes to consider whether there should be a requirement relating to an appropriate number of independent board directors at the group level.

60. The Authority will encourage the relevant solo supervisors of the group's overseas entities to provide, inter alia, the following information²⁴ so that the Authority will be able to conduct a group-wide assessment:

- a. the legal structure of the insurers belonging to the group;
- b. any granting and withdrawal of license for a company forming part of the group;
- c. changes in the board or senior management of any insurance company forming part of the group;
- d. changes in risk management and internal control systems;
- e. significant developments in the financial position of the group or insurers belonging to the group;
- f. location of significant business;
- g. significant investments in group entities;
- h. significant financial links;
- i. transfer of risks to unregulated entities;
- j. events that may endanger the going concern of the group or major insurers belonging to the group;
- k. potential high risk factors for contagion; and
- l. significant operational risk.

²⁴ Ibid

61. As Group-wide Supervisor, the Authority will need to have in place appropriate powers to take supervisory or enforcement actions if the group is not conducting its business activities in a sound and prudent manner. Where the matter pertains to a legal entity subject to another jurisdiction's regulatory provisions, the Authority will confer with the relevant supervisor(s) to ensure a collaborative approach is taken to appropriately address the issue.

4.2 Proposed Group Solvency Framework

4.2.1 Current Solvency Regime

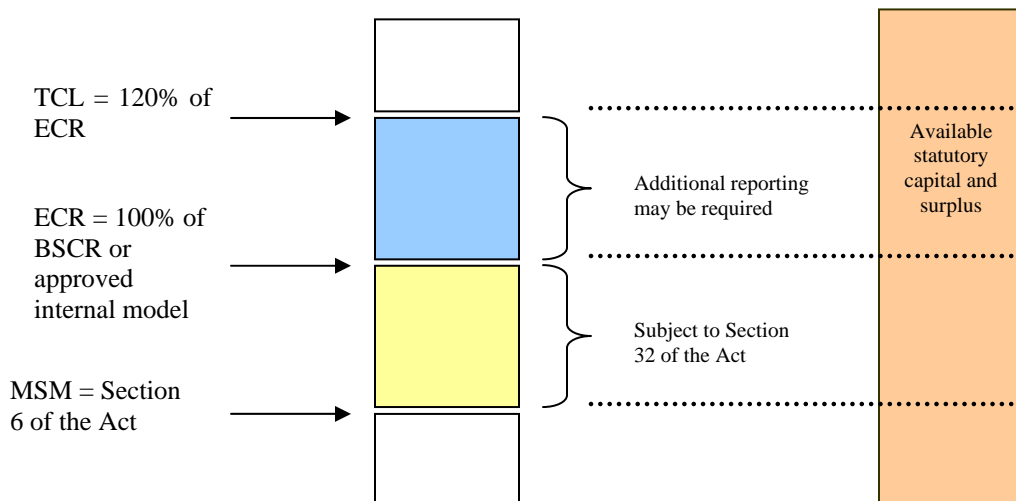
62. The Authority's current solvency regime is restricted to the legal entity level where the solvency requirement depends on the registered class of insurer under section 4 of the Insurance Act 1978 ("the Act").
63. Class 4 insurers, which are generally the largest commercial insurers in the Bermuda market, are subject to a risk-sensitive statutory capital and surplus requirement subject to a \$100 million floor.
64. Class 4 insurers' statutory capital and surplus is determined by the Bermuda Solvency Capital Requirement ("BSCR"). The BSCR applies capital factor charges to fixed income investment risk, equity investment risk, credit risk, premium risk and reserve risk. The capital factor charges are calibrated at 99% Tail Value-at-Risk ("TVaR") (translated to 99.63% Value-at-Risk on account of the Bermuda market's long tail) over a one year time horizon, with full run-off of insurance liabilities. The BSCR contains both a built-in stress test for interest rate/liquidity risk (factoring in asset/liability matching), and an insurer modelled catastrophe risk charge calibrated at 99% TVaR over a one year time horizon.
65. The BSCR also contains an operational risk charge calibrated to the quality of an insurer's risk management policies and procedures. This charge ranges from 1% to 10% of the pre-operational risk BSCR. The Authority has developed a self-assessment tool to assist insurers in evaluating the quality of their risk management and determining the appropriate

operational risk capital charge. The results of the self-assessment are verified during onsite visits and capital add-ons may be applied.

66. In 2009, Class 4 insurers will also have the ability to make application to have their internal models approved for the purposes of determining regulatory capital and surplus. Approval will be subject to stringent criteria surrounding use, statistical quality and calibration examinations.

67. The BSCR takes account of diversification within the insurer’s underwriting portfolio and correlation between credit and reserve risks. The Authority has the ability to impose capital add-ons where the insurer’s risk profile differs materially from the underlying assumptions of the BSCR. A capital add-on may also apply where the Authority feels that circumstances have changed, for example where an approved internal model no longer captures all applicable risks (i.e. a temporary misalignment between an approved internal model and the risk characteristics of the insurer).

68. The existing solvency regime has three regulatory action levels: Minimum margin of solvency (“MSM”), Enhanced Capital requirement (“ECR”), and Target Capital Level (“TCL”), as indicated in the diagram below.



69. The MSM is prescribed in the Act and serves as the floor or minimum level of capital an insurer is required to hold. It is the higher of three tests²⁵, and subject to a \$100 million floor. An insurer that has a capital and surplus level below the MSM is considered insolvent from a statutory perspective, and this will trigger certain intervention powers under the Act.
70. The ECR is equal to the capital requirement yielded by the BSCR model or the approved internal model subject to the MSM floor. Capital levels between the ECR and the MSM may prompt the Authority to issue directions under section 32 of the Act, which may include restrictions on transacting new insurance business or paying dividends until the capital level has been restored. The insurer would not be considered insolvent from a statutory perspective. Although the ECR is the actual capital requirement, the Authority expects insurers to hold capital equal to, or above, the TCL (120% of the ECR). The Authority considers the level between the ECR and TCL to be a safety buffer, and an early warning trigger for increased prudential oversight.

4.2.2 Proposed Group Solvency Approach

71. There are a number of approaches to assessing group solvency. While the Authority proposes to establish a solvency regime for groups, it is mindful that there are issues being debated that would affect the mechanics of the group-wide solvency assessment and its application to groups.
72. The Joint Forum on Financial Conglomerates (“the Joint Forum”) has endorsed a few solvency approaches. Two of these are: a) the consolidation approach, and b) the risk-based aggregation approach:
- a. The consolidation approach assumes that the group is a single economic unit. The group’s solvency capital requirement is based upon consolidated data and is calculated on the basis of a standard formula or an approved internal

²⁵ MSM for the Class 4 insurer is the greater of \$100million; or 50% net written premium (net written premium is 75% gross premium less premium ceded for reinsurance); or 15% Net Loss and Loss Expenses and Other General Insurance Business Reserves The Insurance Returns and Solvency Regulations 1980.

model.²⁶ Intra-group transactions and off-balance sheet exposures are eliminated; however, it is assumed that unlimited total balance sheet guarantees are in place between all legal entities. For groups, the consolidated balance sheet and the off-balance sheet exposures are disaggregated into the different financial sectors. Each entity's regulatory capital level is then compared against the individual capital requirement to identify any capital deficits. The deficits are usually addressed by free transferability of capital.²⁷

- b. The risk-based aggregation approach is suitable in situations where either consolidated financials are unavailable or where intra-group transactions may not be easily eliminated. Group regulatory capital is determined by aggregating the solo capital requirements and subtracting the group-wide capital requirement. Adjustments to the computation are made to avoid double gearing.²⁸

73. The IAIS also has put forward an alternative method, the legal entity method, which views the group as a “set of interdependent legal entities, and not one single entity.”²⁹ The capital requirement for each legal entity is computed, taking into account intra-group exposures. This approach is used in Switzerland where the risks of intra-group exposures must be modelled in order to determine the solvency requirements of each legal entity.

74. The Authority proposes to utilise a flexible approach which has some attributes of each of the previously described methods. More specifically the Authority proposes:

- a. to give groups an option to apply a consolidation or risk-based aggregation approach, subject to agreement by the Authority;
- b. to introduce elements of the legal entity approach by:

²⁶ Directive of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)

²⁷ Supervision of Financial Conglomerates – Papers prepared by the Joint Forum on Financial Conglomerates February 1999

²⁸ Ibid

²⁹ IAIS Issues paper on group-wide solvency assessment and supervision March 2009

- i. taking a conservative “default” position regarding the treatment of unregulated group entities (by requiring a deduction³⁰ of investments in such entities from eligible group capital) or, at a solo level, of intra-group transactions (e.g. by requiring the full amount of intra-group guarantees to be recorded as liabilities), unless
- ii. the firm, at the solo level, applies to the Authority for approval of a modelled assessment of the risk posed by such exposures.

75. The Authority believes that this flexible approach would allow groups to take advantage of diversification benefits in the consolidation method (subject to any restrictions under group support or in the prudent recognition of diversification in the capital model). It would also allow groups to employ the less resource-intensive risk-based aggregation approach. The risk-based aggregation method would incorporate solo solvency calculation based on other regulators’ rules, provided these are deemed equivalent by the Authority (see paragraph 42). Elements of the legal entity approach would allow the risks at a solo level to be more accurately assessed. It would facilitate certain discretionary solvency treatments (e.g. guarantees as admitted assets³¹) to be approved by the Authority if the firm proposes a modelled risk assessment of an intra-group exposure.

76. The Authority further proposes to use the BSCR to determine regulatory group capital, although it recognises that the BSCR framework may require some modification to make it applicable at a group level. Alternatively, groups would be able to make application for their internal models to be approved for the purposes of determining regulatory capital similar to the existing solo solvency regime. Approval will be subject to stringent criteria surrounding use, statistical quality and calibration examinations.

³⁰ This deduction of the value of the investments can potentially result in a deduction greater than 100% if the impact of these investments warrant such a treatment

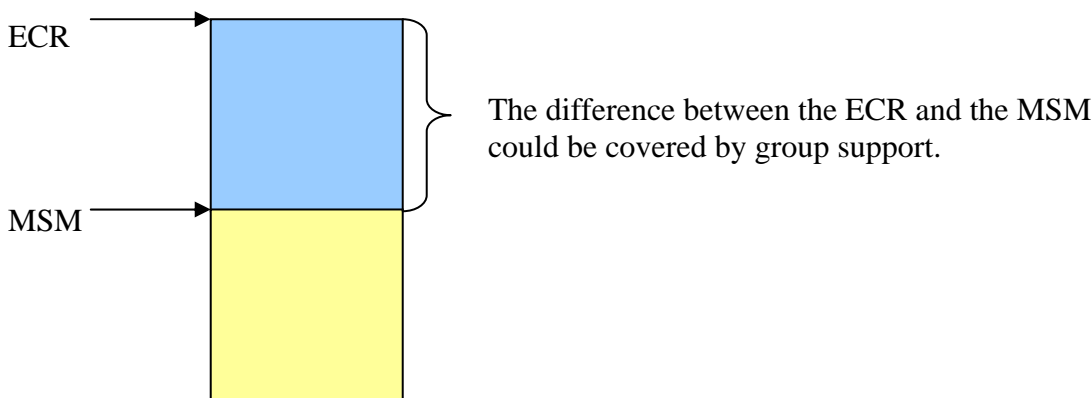
³¹ Admitted assets are assets allowed in the calculation determining available statutory capital and surplus under The Insurance Accounts Regulations 1980 (“the Accounts Regulations”). Certain intra-group exposures such as parental guarantees do not qualify as admitted assets unless approval is granted by the Authority. Contingent obligations on the other hand are treated as liabilities by default, and approval from the Authority is required for waiver.

77. Where the Authority is the solo supervisor, the Authority may accept the Group-wide Supervisor’s assessment of a group’s internal model, provided the Bermuda legal entity’s results could be extracted to confirm compliance with the Act.

4.2.3 Group Support

78. Group support facilitates the efficient allocation of capital and the recognition of diversification benefits for the purposes of calculating group regulatory capital.³² It refers to the “form of cross-guarantee or a one-sided commitment, between the parent company and one or more of its subsidiaries that capital will flow when needed.”³³

79. Recognising diversification benefits may result in the group’s regulatory capital being less than the sum of the legal entities’ regulatory capital requirements. Group support could be used to cover the difference between the legal entities’ MSM and ECR requirements.



80. Group support becomes complicated when the group operates in different jurisdictions. Solo supervisors should consider recognising diversification benefits within the group and allow the legal entities to be capitalised at the MSM level with group support supplementing the difference between the MSM and ECR. The Authority’s approach to recognising diversification benefits is being addressed in our separate work on economic capital models.

³² The issue of groups in the insurance industry: Diversification effects and group supervisor concept – Michaela Koller, CEA Director General April 2008

³³ IAIS Issues paper on group-wide solvency assessment and supervision March 2009

81. A major concern with the concept of group support is the assumption of efficient collaboration between solo supervisors and the Group-wide supervisor. The effectiveness of a group support regime would be hindered if the solo supervisors present any impediments to the transferability of capital, especially under conditions of financial distress. Supervisors are concerned that free movement of capital, may in fact be restricted under these conditions, and result in the legal entity's, and potentially, the group's financial impairment.
82. The Authority is aware that group support has been removed from the passage of the Directive of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance ("Solvency II Directive"); however, the Authority still believes that group support, given the appropriate conditions, could be an important component of an efficient group-wide supervisory regime. The Authority will continue to monitor the issue being deliberated in international forums.
83. Accordingly, the Authority seeks views on whether it should allow group support to the extent that it exists in other jurisdictions. If allowed, the proposed method of assessing group-wide solvency would be predicated on the effectiveness of the group support structure in place. The Authority may also explore the option of entering into bilateral or multilateral agreements with other jurisdictions to affect group support for groups that operate in those jurisdictions.
84. The Authority will need to develop detailed criteria governing the acceptance of group support as both a Group-wide Supervisor and solo supervisor (if such a regime is permitted). At a high level, the criteria may include, inter alia:
- a. the parent must provide a declaration of group support;
 - b. group support must be backed by a legally binding document approved by the Authority;
 - c. the group must provide information to the Authority on the existence of any issues or requirements that may hinder or otherwise compromise the transferability of capital;

- d. capital must be fungible within the group, even under stressed conditions;
- e. capital must in fact be available; and
- f. the minimum criteria for group support has been met by other jurisdictions.

4.2.4 Proposed treatment of Intra-group Transactions and Risk Concentration

85. Intra-group transactions occur where subsidiaries within the group depend on the parent and/or other subsidiaries to perform a particular obligation. The effects of intra-group transactions may pose complex issues and supervisors need to have a clear understanding of the structure of these transactions, the links between different parts of the group, and the resultant effects upon the group's solvency.
86. Disclosures on intra-group transactions allow supervisors "to evaluate the channels through which the holding company, subsidiaries and affiliates of a regulated legal entity can influence the financial health of that legal entity."³⁴ Such disclosures, supplemented by discussions with the group's management, provide valuable information regarding how intra-group exposures are monitored to ensure that limits are not breached.
87. Broadly speaking, the Authority's proposed approach to intra-group transactions at the group level is to require disclosure of such transactions in order to inform its supervision and permit the application of capital add-ons where the Authority feels risks are not properly assessed and managed.
88. The Authority's analysis of the group legal entity approach to solvency has resulted in reconsideration of the solo treatment of some of these intra-group exposures. The Authority's existing position is to take a generally conservative "default" approach to the treatment of such exposures at a solo level. For example, currently (where the exposure is a contingent obligation) firms are required to treat the full nominal value of an intra-group

³⁴ Supervision of Financial Conglomerates – Papers prepared by the Joint Forum on Financial Conglomerates February 1999

guarantee as a liability unless they apply to the Authority and obtain approval to receive a waiver.

89. The Authority’s proposed approach would require firms to present a modelled risk assessment when seeking to have intra-group exposures approved as admitted assets or reduced in value as liabilities before such waivers or discretions are granted. The Authority proposes to accept existing immaterial intra-group exposures (where prior approval was granted) and allow them to be grandfathered through amendments in legislation.
90. Further, where approvals relating to both admitted assets and liabilities were previously granted, the Authority will re-evaluate the material intra-group exposures and set a transitional period. Insurers would be required to re-apply by presenting their modelled risk assessment; otherwise they would be obligated to revert to the default or standard conservative treatment.
91. The Authority’s proposed group-wide solvency approaches would require additional disclosures for items declared in Line 4³⁵ and other intra-group transactions such as reinsurance, in order to make a proper assessment of their impact. The Authority proposes the following:
- a. enhanced disclosures of intra-group transactions within the statutory financial statements;
 - b. notification to the Authority, on a quarterly basis of any material intra-group transactions that occurred within the quarter (the materiality threshold will be set in relation to the size of the group);
 - c. submission of any corresponding information from foreign supervisory authorities responsible for the supervision of other legal entities within the group;

³⁵ Schedule I Line 4 “Investments in and advances to Affiliates” of the Accounts Regulations. Note: Further amendments to the statutory financial statements are being considered in the Disclosures workstream discussion. Details will be covered in the series of consultation papers on Disclosures.

- d. credit standing of counterparties; and
- e. financial statements of counterparties, where deemed necessary.

92. Based on the additional information, the Authority's assessment may include:

- a. determining the adequacy of risk management processes in place, including those pertaining to intra-group transactions;
- b. requiring regular reporting to assist in understanding the impact of intra-group transactions;
- c. requiring additional capital commensurate with the incremental risk exposures;
- d. encouraging public disclosure; and
- e. liaising closely with other supervisors to ascertain their concerns and coordinating supervisory action where deemed appropriate.

93. The Joint Forum, in its paper "Cross-sectoral review of group-wide identification and management of risk concentrations", defined risk concentration as exposures that have the following characteristics:

- a. the potential to produce losses large enough to threaten a financial institution's health or ability to maintain its core operations; or
- b. the potential to produce a material change in an institution's risk profile.

94. Risk concentrations may have single or closely related drivers, possibly having different impacts on an entity. Risk concentration must be integrated into the group's overall risk assessment. Such concentrations may arise from the group's assets, liabilities, off-balance sheet items, or through executing or processing transactions.

95. Groups tend to view and manage risk concentrations separately within the various risk categories; however, these concentrations may "arise from (interrelated) exposures across the

risk categories, rendering a silo-based approach insufficient as potential concentrations across risk categories may not be captured.”³⁶

96. The Authority proposes to address risk concentrations by requiring that:
- a. the risk management framework surrounding such concentrations are adequate and approved by the board;
 - b. the board monitors these concentrations at the group level;
 - c. where appropriate, the parent conducts stress and scenario tests on the group’s risk concentrations to determine the impact of changes in the group’s risk profile arising from market conditions; and
 - d. capital add-ons or other regulatory action may be applied, where deemed necessary.

4.2.5 Proposed Eligible Capital Structure

97. “Sufficient capital is critical to an insurer’s ability to meet its obligations to policyholders and creditors and to finance future growth in its business.”³⁷ The Authority’s existing solvency regime does not differentiate between the quality of capital instruments that are suitable to meeting this objective. The Authority does, however, address the issue of admitted assets within the Accounts Regulations, which allows the Authority to ‘filter’ assets for the purposes of determining statutory capital and surplus. Schedule V of the Accounts Regulations identifies statutory capital as capital stock, contributed surplus and any other fixed capital.

98. Article 93 of the Solvency II Directive identifies the following as considerations that should be reviewed when determining the quality of capital for solvency purposes:

³⁶ The Joint Forum Cross-sectoral review of group-wide identification and management of risk concentration April 2008

³⁷ IAIS Draft Guidance Paper on the Structure of Capital Resources for Solvency Purposes March 2009

- a. whether the item is available or can be called up on demand to fully absorb losses on a going concern and/or winding up basis;
- b. whether in the case of winding up, the total amount of the item is available to absorb losses and the payment of the instrument to the holder is subordinated to obligations to policyholders and/or beneficiaries;
- c. whether the item is free from requirements or incentives to redeem the nominal sum;
- d. whether the item is free from mandatory fixed charges; and
- e. whether the item is free of encumbrances.

99. The IAIS' position with respect to capital quality assessment is consistent with the Solvency II Directive. The IAIS cites:³⁸

- a. the extent by which, and in what circumstances, the capital element is subordinated to policyholders' interests;
- b. the extent by which the capital element is available to absorb losses on a going concern, winding up or insolvency basis;
- c. the period that the capital element is available;
- d. the availability of contingent and unpaid capital when required;
- e. the extent by which the capital element is encumbered or obligated to make mandatory payments;
- f. the extent by which the capital element facilitates or hinders future re-capitalisation; and
- g. any restrictions on the transferability of assets or capital resources within an insurer's business, e.g. ring-fenced funds or other arrangements.

100. The Solvency II Directive advocates a tier structure that differentiates the quality of capital to be considered for solvency purposes. The IAIS similarly advocates the tier

³⁸ IAIS Draft Guidance Paper on the Structure of Capital Resources for Solvency Purposes March 2009

structure as an acceptable option to rank capital according to its quality. The tier structure comprises capital instruments that satisfy the following criteria³⁹:

- a. Tier 1 capital is considered the highest quality capital that is available when required and can fully absorb losses at all times;
- b. Tier 2 capital would include other instruments that lack some of the characteristics of Tier 1 capital but they are able to provide a measure of loss absorption and are subordinated to the rights of policyholders. The quality of Tier 2 capital falls short of the qualitative traits of Tier 1 capital, however, this tier's capital can provide protection to policyholders; and
- c. Tier 3 capital provides loss absorbency under certain conditions such as winding up or insolvency.

101. The Solvency II Directive elaborates on the eligibility limits within the tier structure when determining regulatory capital requirements:

- a. the eligible amount of Tiers 2 and 3 would be limited to twice the amount of Tier 1; and
- b. the eligible amount of Tier 3 would be limited to 50% of the total of Tiers 1 and 2.

102. The Authority proposes to adopt the same tier structure advocated by the Solvency II Directive for determining regulatory capital for groups, taking into account the characteristics as outlined in the preceding paragraphs. The Authority proposes the following capital instruments be allocated to the various tiers:

- a. Tier 1 – common stock, non-cumulative preference shares, contributed surplus and cash.
- b. Tier 2 – hybrid capital instruments, long-term subordinated debt and convertible debentures.

³⁹ Ibid

- c. Tier 3 – short-term subordinated debt, approved parental guarantees and approved irrevocable letters of credit.

103. The Authority's proposed assessment of a capital instrument is based primarily on the characteristics of the instrument and how well it satisfies the criteria in paragraph 100. Accordingly, the Authority would reserve the right to class any instrument normally qualifying for a certain tier into another tier where there are unique contractual provisions that change the nature and quality of the instrument. The Authority would make such determinations based upon the instrument's ability to absorb losses, availability when required and subordination to policyholders' obligations. The Authority invites comments on these initial proposals and whether there are other typical capital instruments utilised in the Bermuda market that require classification.

104. The Authority would consider eligible capital within Tiers 1 and 2 to satisfy the group's MSM and eligible capital in Tiers 1, 2 and 3 to satisfy the group's ECR.

105. It should be noted that the Authority's work on eligible capital will be taken forward separately and on a faster track. The eligible capital framework will apply to both groups and insurance legal (solo) entities. The Authority plans to publish a consultation paper on this subject in the third quarter of 2009.

4.3. Proposed Treatment of Unregulated and Non-Financial Entities

106. Groups may contain non-financial entities that pose similar concerns as their financial counterparts. These non-financial subsidiaries may be unregulated and could conduct activities that can threaten the group's solvency or liquidity position. The issue becomes more complex where these non-financial entities operate outside Bermuda and are not subject to any supervisory oversight.

107. Where the non-financial entity is the ultimate parent or an intermediate parent, such as a holding company, the IAIS supports the notion that aspects of supervisory oversight should

be extended to those entities, in areas such as corporate governance, internal controls and group-wide solvency assessments⁴⁰. In its paper, “Principles on group-wide supervision”, the IAIS asserts that the “supervisor should have appropriate power and authority to assess and ensure compliance with corporate governance requirements at the head of the group.”⁴¹

108. Similarly, the Authority proposes to extend its supervisory remit to non-financial parent operations located in Bermuda. The scope of the proposed supervisory oversight will be limited to the Authority being able to obtain information and prescribe requirements relating to corporate governance and risk management, and include such entities in the consolidated solvency assessment. Further, the Authority proposes to be able to exercise enforcement powers over the parent and the group. The Authority does not propose to regulate the non-financial parent’s operations, nor would it be regarded as a “fully regulated [entity].”⁴²

109. For non-financial subsidiaries, the Authority’s proposal is that the group will be required to deduct the value of its investment in the subsidiary from the group’s available regulatory capital. However, the Authority would provide firms with the option of applying for permission to use a modelled assessment of the risks in that subsidiary, which would then be captured in the group solvency assessment. Firms using the aggregation method could model the risks of a particular legal entity and apply the BSCR (and overseas rules) to other entities.

110. The Authority proposes that this approach may also be applied to unregulated financial subsidiaries. For example, some groups may include unregulated financial derivatives entities. The Authority also understands that some groups contain unregulated investment or asset management companies that pool the investments of individual group legal entities. The Authority believes it is important that the risks of these entities are properly captured in the consolidated solvency assessment, either by deduction or modelling the inherent risks. Where the risk of loss to the group may not be limited to the size of the investment in a subsidiary (e.g., a financial products unit that writes derivatives), the Authority may impose a

⁴⁰ IAIS Issues paper on group-wide solvency assessment and supervision March 2009

⁴¹ IAIS Principles on group-wide supervision October 2008

⁴² Ibid

capital add-on if the group opts for the deduction approach and does not fully model the risks of the subsidiary.

4.4. Proposed Group Statutory Reporting and Filing Requirements

111. Inherent in the proposals discussed in the various sections, is the requirement for the Authority to collect additional information to assist in conducting its group-wide assessment regime. This includes information that may come directly from the Group-wide Supervisor where the Authority does not hold this position.

112. The previous sections have identified the types of additional information the Authority would require in order to fulfil its supervisory assessment of the group and its risk exposures.

113. As a solo supervisor, the Authority may recognise the statutory group reporting and filing information submitted to the Group-wide Supervisor as acceptable, and as such, may request and review the information along with the solo statutory reporting for the legal entities.

114. Presently, the Act requires that Class 4 insurers prepare audited financial statements prepared in accordance with United States, United Kingdom and Canada Generally Accepted Accounting Principles (“GAAP”) or International Financial Reporting Standards (“IFRS”). The Authority proposes to extend this reporting requirement to groups.

115. The Authority reserves the right to request additional information and/or more frequent reporting as it may deem necessary, in order to conduct its group-wide supervisory assessment.

116. The Authority will be issuing its consultation paper on Disclosures in the second quarter of 2009, which will address, in greater detail, the proposed disclosure requirements that will assist the Authority in its supervisory assessments.

5. Implementation timetable for Group-wide Supervision

117. The Authority proposes to implement group-wide supervision for groups by the fourth quarter of 2011. The expected timeline is as follows:

	2009	2010	2011
- The Authority to issue a discussion paper for comments/ feedback from stakeholders	Q1		
- The Authority to review stakeholders' feedback/ comments on the discussion paper	Q2		
- The Authority to issue a consultation paper for comments/ feedback from stakeholders		Q1	
- The Authority to review stakeholders' feedback/ comments on the consultation paper		Q2	
- Proposed enactment of legislation or regulations to effect group-wide supervision		Q4	
- Full implementation of group-wide supervision			Q4

118. In parallel with the Authority's work to develop the policy and legislative framework for group-wide supervision, the Authority will use the supervisory onsite programme and host supervisory colleges as a means to continue to develop knowledge of Bermuda's insurance groups. The Authority will also shortly request that Class 4 and Class 3B insurers submit information on a number of group-related issues. This information will help inform the Authority's policy and supervisory work. The preparation for this information should also help insurers focus on the key issues raised in this paper. The Authority's request to each insurer will include:

- a. indicate whether it feels that the Authority will likely be its Group-wide Supervisor under the approach described above or whether there is another supervisor which is willing and able to take on this role;
- b. indicate whether it is currently subject to group-wide supervision and prepares group solvency calculations for other supervisors (for example under the EU

Insurance Groups Directive). Where this is the case, the Authority will request to see these calculations;

- c. provide an inventory of material intra-group transactions, to start the process of disclosure of these instruments; and
- d. provide a listing of group legal entities, differentiating between regulated and unregulated entities in Bermuda, the European Union, the United States, other G10 countries⁴³, and other non-G10 countries.

6. Conclusion

119. The issues and considerations advanced in this discussion paper aim to set the stage for the implementation of a group-wide supervisory regime in Bermuda. They highlight the fact that there are many important issues and challenges that require thoughtful and deliberate consideration. The discussions in this paper are preliminary and the Authority recognises that there is a need for more detailed analysis and consideration of the issues.

120. The Authority has noted that there are various approaches to group-wide supervision under consideration in many jurisdictions, and supervisory cooperation with other foreign regulators will be a key requirement for the group-wide supervisory regime to be efficient.

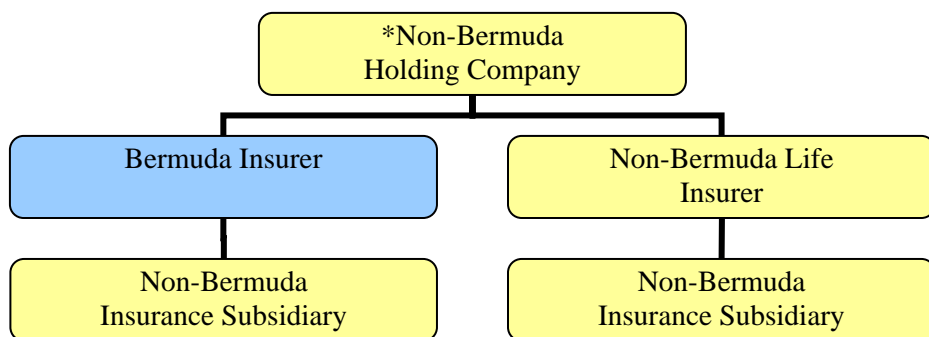
121. Going forward, the Authority proposes to adopt group-wide supervision as a supplement to the existing solo supervisory regime. The Authority proposes to review the most appropriate means of achieving this goal via the mechanism of primary and secondary legislation, code of conduct as well as guidance. This should provide the necessary certainty and transparency with regard to the issues that have been highlighted in this paper.

⁴³ Group of 10 countries is made up of 11 industrialised countries - Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States

APPENDIX I: TYPES OF GROUP STRUCTURES OPERATING IN BERMUDA

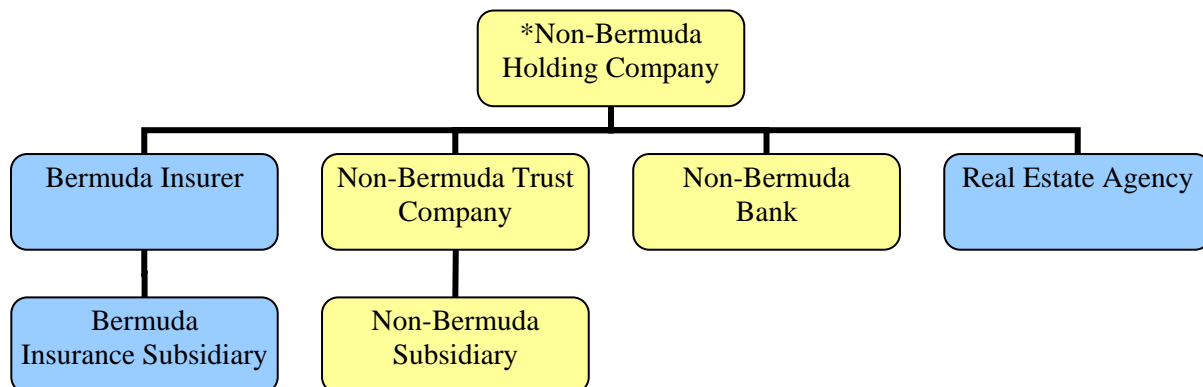
For the purposes of this paper, we identified three primary types of group structures that come under the purview of the Authority. They are as follows

Financial Group Type A: Homogeneous financial group



Financial Group Type A is a homogeneous financial group consisting of predominantly licensed financial entities that share the same sectoral characteristics. The companies can be located in either one jurisdiction or operate in various jurisdictions.

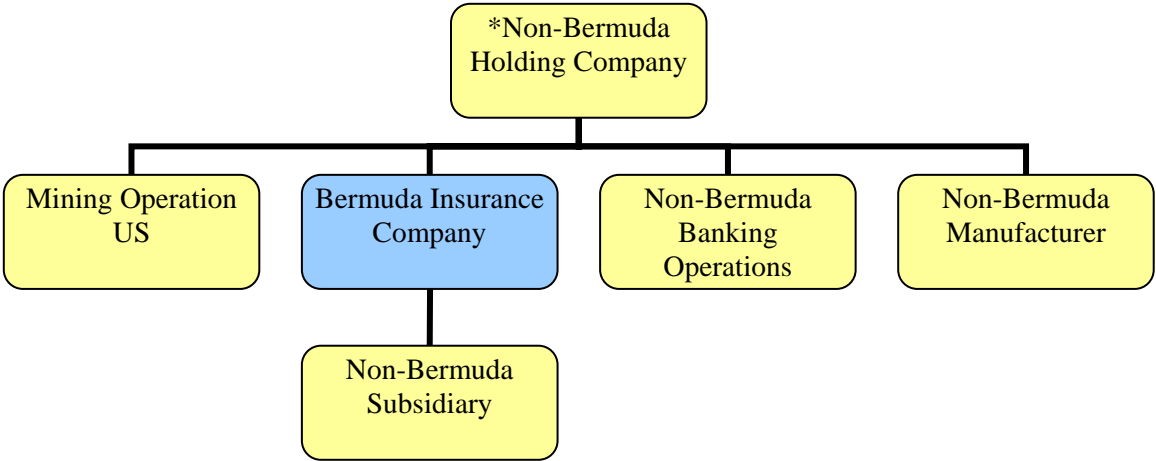
Financial Group Type B: Heterogeneous financial group



* The holding company may also be incorporated in Bermuda

Financial Group Type B is a heterogeneous financial group (or financial conglomerate) consisting of predominantly licensed financial entities that operate in different financial sectors. This group can be led by a non-financial parent and may contain subsidiaries that conduct non-financial activities.

Financial Group Type C: Mixed conglomerate



Financial Group Type C is a mixed conglomerate where the group conducts predominantly non-financial business activities. This group may have a financial subgroup that operates alongside non-financial company types.

APPENDIX II: THE AUTHORITY'S PROPOSED APPROACH REGARDING APPOINTMENT OF THE GROUP-WIDE SUPERVISOR

